UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Midwest Independent Transmission	**)**	**Docket No. ER02-111-000**
System Operator	**)**	**and ER02-652-000**

COMMENTS OF THE ILLINOIS COMMERCE COMMISSION

Pursuant to Rule 602 of the Commission's Rules of Practice and Procedure, 18 C.F.R. 385.602, the Illinois Commerce Commission ("ICC") hereby submits its comments in the above-captioned proceeding in response to an Offer of Settlement submitted by the Midwest Independent Transmission System Operator ("Midwest ISO") on April 19, 2002.

I. BACKGROUND

On October 16, 2001, the Midwest ISO filed three proposed tariff revisions to its OATT. The Midwest ISO proposed to: (1) modify Schedule 10 (the Midwest ISO cost recovery adder) of the Midwest ISO's OATT to provide ITCs that join the Midwest ISO under Appendix I of the Midwest ISO Agreement with the option of electing bundled or unbundled RTO services; (2) amend the Midwest ISO's OATT to include a new alternate cost recovery adder, under Schedule 10-A, to reflect the terms of Section 4.8 of the Settlement Agreement approved in Illinois Power Company, et al., 95 FERC ¶61,183, reh'g denied, 96 FERC ¶61,026 (2001); and (3) modify Attachment I of the Midwest ISO's OATT to reflect the list of customers that would be eligible for the alternate cost recovery adder under Schedule 10-A. The Midwest ISO proposed, among other things, to revise Schedule 10 of its OATT to grant ITCs the option to contract with the Midwest ISO for unbundled RTO services. In addition, the Midwest ISO proposed a modified

ITC capital cost formula that excludes non-FERC jurisdictional entities that are members of an ITC from paying any of the Midwest ISO's capital costs.

In a December 14 Order, the Commission accepted and suspended the Midwest ISO's Schedule 10/10-A revisions to its OATT and established hearing and settlement judge procedures.

On December 28, 2001, Midwest ISO filed in Dkt. No. ER02-652-000 proposed revisions to its OATT to add interim Schedule 10-B, intended to recover the Midwest ISO's monthly capital costs and operating costs for transmission services provided during January 2002, and applicable only to the Transmission Owners and the International Transmission Company.

On February 26, 2002, the Commission issued an Order consolidating the ER02-652 issues with those being addressed in the ER02-111 proceeding.

On March 13, 2002, the Commission denied rehearing of its December 14 Order in Dkt. ER02-111.

An Administrative Law Judge was appointed and several settlement conferences were held. The ICC did not participate in the settlement conferences. According to the Midwest ISO's April 19 filing, the parties that participated in the settlement conferences reached a partial settlement of the issues in this consolidated proceeding, represented by the Midwest ISO's April 19 Offer of Settlement. As pertinent to these comments, Section 2.13 of the Offer of Settlement provides for the creation by the Commission of a "regulatory asset" representing payment of Schedule 10 charges which a Transmission Customer "cannot recover from its customers . . .". The Offer of Settlement further provides that the order approving the settlement provide "assurance for probable recovery of such regulatory assets through future revenues."

II. POSITION AND RECOMMENDATION

Section 2.13 of the Midwest ISO's April 19 Offer of Settlement should be deleted in its entirety. That section of the Offer of Settlement is a transparent, improper attempt to constrain future deliberations of state regulators. Alternatively, if Section 2.13 is not deleted in its entirety, the ICC recommends that the following two sentences be added to the end of Section 2.13:

> However, nothing is this Section 2.13 shall be construed as either authorizing or prohibiting public utilities that serve bundled retail load under state-jurisdictional tariffs from recording Schedule 10 costs applicable to that bundled retail load in a regulatory asset account. Furthermore, the Parties agree that, notwithstanding any provision in this Section 2.13, the order approving this Settlement should not be construed to constrain, in any way, the otherwise applicable authority of state regulatory authorities to take costs into account in setting retail rates.

III. DISCUSSION:

A. The ICC Accepts the Settlement Offer's Premise that the Schedule 10 Adder will be Applied to Utilities that Use the Transmission System to Provide Bundled Retail Service—But, Commission Approval of Section 2.13 of the Settlement Offer Would be an Improper Incursion on State Jurisdiction

In its "Explanatory Statement in Support of Offer of Settlement," the Midwest ISO points out that the Commission, in its December 14, 2001 Order, "rejected protests to the application of the Schedule 10 adder to bundled retail load and grandfathered contracts finding that those allegations are more appropriately addressed on rehearing of Opinion No. 453." Midwest ISO Explanatory Statement in Support of Offer of Settlement at 4. Therefore, the Offer of Settlement appears to be premised on the assumption that the Schedule 10 adder will be applied to utilities using the transmission system to provide bundled retail service. The ICC understands that the Offer of Settlement is based on this bundled retail load premise and does not take issue with that premise here.

The ICC does, however, take issue with Section 2.13 of the Offer of Settlement, a section that appears to be related to the decision to apply the Midwest ISO's Schedule 10 adder to utilities serving bundled retail load. Section 2.13 provides as follows,

> 2.13 Regulatory Asset. By its approval of this Settlement, the Commission agrees that any payments of Schedule 10 charges which a Transmission Customer under the MISO OATT cannot recover from its customers, together with interest calculated in accordance with Section 35.19a(a)(2)(iii)(A) of the Commission's regulations, represents a regulatory asset under the Commission's Uniform System of Accounts properly classified in Account No. 182.3, Other Regulatory Assets. The Parties agree that the order approving this Settlement should provide assurance for probable recovery of such regulatory assets through future revenues.

On its face Section 2.13 represents an improper incursion into state jurisdiction and would, if approved by the Commission, lead inevitably to challenges to state commission exercise of regulatory ratemaking authority in the conduct of future prudence determinations and retail rate determinations.

B. It is Improper for the Commission to Authorize State-Jurisdictional Utilities to Record Schedule 10 Costs in a Regulatory Asset Account

Section 2.13 would require the Commission to give its ex ante approval to state-jurisdictional public utilities to record Schedule 10 costs that the utilities claim not to be able to recover from retail customers as a regulatory asset.[1] The ICC is unaware of any jurisdictional theory under which the Commission would be permitted to issue rulings having as their effect the prohibition of duly authorized regulatory agencies from making examinations and determinations that are properly within their sphere of state authority. In particular, if the Commission gives prior approval for state-jurisdictional public utilities to record allegedly unrecovered Schedule 10 costs in Regulatory Asset Account No 182.3, it can only give rise to

[1] However, neither should the Commission ex ante prohibit state jurisdictional utilities from recording allegedly unrecovered Schedule 10 costs in a regulatory asset account.

state jurisdictional utility cries of pre-emption when state commissions later examine the public utility's decision to make such accounting entries.

C. The Commission Does Not Have the Authority to Provide the Rate Recovery Assurance Sought in Section 2.13 With Respect to State-Jurisdictional Utility Service

If the Commission decides to approve Section 2.13 as written, not only will it be giving improper prior authorization to state-jurisdictional public utilities to record allegedly unrecovered Schedule 10 costs as a regulatory asset, the Commission would also be providing "assurance for probable recovery of such regulatory assets through future revenues." With respect to the recovery of otherwise unrecovered Schedule 10 costs through retail rates, the Commission has already decided that it would not assert jurisdiction to provide retail cost recovery assurances similar to those which the drafters of Section 2.13 request. Midwest Independent Transmission System Operator, Inc., et al., Opinion No. 453-A, Order Denying in Part and Granting in Part Rehearing and Providing Clarification, 98 FERC ¶ 61,141 (2002). The responsibility to establish retail rates, and the underlying evaluation of prudent utility costs, properly lies with duly authorized state regulatory agencies. It would be improper for the Commission to attempt to provide the retail rate recovery "assurance" that the parties are seeking by including this language in Section 2.13.

i. The Commission has already addressed and rejected the approach presented by Section 2.13

As noted above, the Commission has recently addressed and resolved this issue as it concerns these Schedule 10 adder costs. In Opinion No. 453-A issued on February 13, 2002, the Commission provided additional guidance regarding the transition to regional operation of the Midwestern electric transmission grid by the Midwest ISO. In that Order, the Commission stated:

> Intervenors ask us to provide the transmission-owning members with authority to pass the Cost Adder charges associated with bundled retail and grandfathered load on to the ultimate customers. Regarding the bundled retail customers, retail contracts are not FERC-jurisdictional and as we have stated above, we are not asserting jurisdiction over these contracts. Rate issues associated with these agreements should be taken up with the appropriate state commissions. .

Midwest Independent Transmission System Operator, Inc., et al., Opinion No. 453-A, Order Denying in Part and Granting in Part Rehearing and Providing Clarification, 98 FERC ¶ 61,141 (2002).

In ruling on the Midwest ISO's proposed Offer of Settlement, the Commission should reject Section 2.13 of the Settlement Offer and should, once again, rule that rate issues associated with assessment of Schedule 10 adder costs to state-jurisdictional utilities "should be taken up with the appropriate state commissions."

ii. Section 2.13 appears designed to provide state jurisdictional utilities the opportunity to avoid commitments made under retail rate freeze provisions

The issues being addressed herein are particularly acute for states, such as Illinois, that have retail rate freezes (or effective retail rate freezes) established either through statute or regulatory action. For such states, Commission approval of Section 2.13 appears designed to provide state jurisdictional public utilities with arguments to evade retail rate freeze commitments. For this additional reason, Section 2.13 is improper.

Section 16-111 of Illinois's Public Utilities Act (220 Illinois Compiled Statutes [ILCS] 5/16-111) was enacted in 1997. Subject to certain exceptions, it fixed the rates of State-jurisdictional electric public utilities at rates in effect on October 1, 1996 for the "mandatory transition period," currently defined in Section 16-102 as the period from December 16, 1997, through January 1, 2005. During that period, the ICC is precluded from lowering or restructuring the rates of an electric utility except upon request of that utility. Also, during that

period, the ICC is precluded from increasing the rates of an electric utility unless the utility qualifies for an increase under Section 16-111(d). 220 ILCS 5/16-111(d).

An Illinois electric utility is authorized to seek such rate relief if it demonstrates that the two-year average of its earned return on common equity is below the two-year average for the same two years of the monthly average yields of 30-year U.S. Treasury bonds. By the same token, if a utility's earnings exceed an amount yielded by a formula set forth in Section 16-111(e), the utility is required to make a partial refund of the overearnings to its retail customers. 220 ILCS 5/16-111(e).

The rates set by the Illinois General Assembly for the mandatory transition period were based on the rates in place as a result of prior ICC orders on October 1, 1996, but were not based on any specific legislative finding of recoverable expenses or cost of capital. In essence, the Illinois General Assembly permitted electric utilities to cut expenditures and to write down, amortize or depreciate assets without fear of ICC action to lower rates during the mandatory transition period (see, for example, 220 ILCS 5/16-111(g)(4) and (h), and 5-104(c)). At the same time, in order to protect electric utilities and their customers from unforeseen problems or profit levels, the General Assembly created a "deadband" of utility earnings—below the lower limit of the deadband, electric utilities could (and can) seek rate increases, and above that limit, they are required to share their earnings by means of a per kilowatthour credit.

It would, thus, be inaccurate for an Illinois utility to imply that there are currently any costs, including the administrative fees recoverable under the MISO OATT, that it "cannot" recover. If expenses for transmission services, or for any other item, cause the utility's earned rate of return on common equity to fall below the two-year average for the same two years of the

monthly average yields of 30-year U.S. Treasury bonds, the utility is free to seek rate relief from the Illinois Commerce Commission.

iii. Other legislative and judicial rulings make the Section 2.13 approach improper in a retail rate setting

Finally, some states may have legislative and judicial prohibitions to the recording of regulatory assets. For example, the Illinois Supreme Court has disallowed the recovery of certain deferred costs. Business and Professional Persons for the Public Interest v. Illinois Commerce Commission, 146 Ill. 2d 175 (1991)("BPI II"). The BPI II Court determined that past utility expenses for depreciation were treated as operating expenses subject to test year principles as set forth in ICC rules and, accordingly, such costs were not allowed recovery as a deferred expense. Moreover, even where some amount of deferred charge recovery is warranted, Illinois law requires that deferred charge recovery be limited to ameliorating the effect of the harm. BPI II, 146 Ill. 2d at 248. Thus, to avoid single-issue ratemaking problems, deferred charges are not examined in isolation. Id., at 249. Even if one were to assume that there had been an inability of a transmission customer to recover its Schedule 10 costs in the past, in the absence of some showing of financial harm, ICC precedent as interpreted by the Illinois Supreme Court requires an examination of all of the utility's revenues and expenses to determine the extent, if any of financial harm.

Ratemaking with regard to the provision of retail electric service is a matter uniquely within the province of state authorities. Consistent with this core ratemaking principle, the Commission has recognized that bundled retail contracts are not FERC-jurisdictional and that rate issues associated with those contracts should be taken up with state commissions . Midwest Independent Transmission System Operator, Inc., et al., Opinion No. 453-A, Order Denying in Part and Granting in Part Rehearing and Providing Clarification, 98 FERC ¶ 61,141 (2002).

IV. CONCLUSION:

WHEREFORE, for each of the aforementioned reasons, the ICC respectfully requests that Section 2.13 of the Midwest ISO's April 19 Offer of Settlement in this proceeding be deleted. Alternatively, if the Commission decides not to delete Section 2.13 in its entirety, then Section 2.13 should, at least, be revised as proposed in Section II of these Comments to exclude from its coverage public utilities that serve bundled retail load under state-jurisdictional tariffs.

Dated: May 9, 2002

Respectfully submitted,

ILLINOIS COMMERCE COMMISSION

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